

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF MILBURN WATER)	
DISTRICT FOR A RATE ADJUSTMENT)	CASE NO.
PURSUANT TO THE ALTERNATIVE RATE)	91-459
FILING PROCEDURE FOR SMALL UTILITIES)	

O R D E R

On December 16, 1991, Milburn Water District ("Milburn") filed its application for Commission approval of a proposed increase in its rates for water service. Commission Staff, having performed a limited financial review of Milburn's operations, has prepared the attached Staff Report containing Staff's findings and recommendations regarding the proposed rates. All parties should review the report carefully and provide any written comments or requests for a hearing or informal conference no later than 15 days from the date of this order.

IT IS THEREFORE ORDERED that all parties shall have 15 days from the date of this Order to provide written comments regarding the attached Staff Report or requests for a hearing or informal conference. If no request for a hearing or informal conference is received, then this case will be submitted to the Commission for a decision.

Done at Frankfort, Kentucky, this 12th day of March, 1992.

PUBLIC SERVICE COMMISSION


For the Commission

ATTEST:


Executive Director

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF MILBURN WATER)	
DISTRICT FOR A RATE ADJUSTMENT)	
PURSUANT TO THE ALTERNATIVE RATE)	CASE NO. 91-459
FILING PROCEDURE FOR SMALL)	
UTILITIES)	

STAFF REPORT

March 9, 1992

Prepared By: Mark C. Frost
Public Utility Financial
Analyst, Chief
Water and Sewer Revenue
Requirements Branch
Rates and Tariffs Division

Prepared By: Nicky Moore
Public Utility Rate Analyst
Communications, Water and
Sewer Rate Design Branch
Research Division

STAFF REPORT

ON

MILBURN WATER DISTRICT

CASE NO. 91-459

A. Preface

On December 16, 1991, the Milburn Water District ("Milburn") filed its application seeking to increase its rates pursuant to the Alternative Rate Filing Procedure for Small Utilities. Milburn's proposed rates would produce an increase in its annual revenues of \$10,397, an increase of 37.47 percent over test-period normalized revenues from rates of \$27,748.

In order to evaluate the requested increase, the Commission Staff ("Staff") chose to perform a limited financial review of Milburn's operations for the test period, the calendar year ending December 31, 1990. Mark Frost and Scott Lawless of the Commission's Division of Rates and Tariffs performed its limited review on February 3 and 4, 1992.

Mr. Frost is responsible for the preparation of this Staff Report except for Section B, Operating Revenues; Section D, Rate Design; and Appendix A, which were prepared by Nicky Moore of the Commission's Research Division. Based on the findings contained in this report, Staff recommends that Milburn be allowed to increase its annual revenues from rates by \$5,848.

Scope

The scope of the review was limited to obtaining information as to whether the test-period operating revenues and expenses were

representative of normal operations. Insignificant or immaterial discrepancies were not pursued and are not addressed herein.

B. Analysis of Operating Revenues and Expenses

Operating Revenues

Milburn's statement of operations filed in its application shows operating revenue from water sales of \$31,546.78. The billing analysis filed with the application is based on a test period ending December 31, 1990. On an annual basis, it generates revenue from water sales in the amount of \$27,747.95. The difference between the statement of operations and the billing analysis is \$3,798.00. The Staff, after investigation, found an error in the revenue reported in the general ledger of Milburn in the amount of \$3,798.00, and after correction, the Staff concurs with Milburn's billing analysis and has used the revenue produced by the billing analysis in its determination of revenue requirements. Under the proposed rate schedule, Milburn's billing analysis will produce operating revenues of \$33,596.00.

Operating Expenses

Milburn reported operating expenses of \$29,168 for the test period. The following are Staff's recommended adjustments to Milburn's test-period operations:

Purchased Water: Milburn reported test-period purchased water expense of \$10,742. A detailed analysis of the purchased water invoices revealed that in the test period Milburn purchased 9,768,000 gallons of water at a cost of \$9,769, a difference of \$973 from the amount Milburn reported. Milburn mistakenly

included its payment of the October bill twice in the general ledger, and when the 1990 compilation was performed, the accountant failed to correct Milburn's error. Accordingly, Staff recommends that purchased water expense be decreased by \$973.

During the test period Milburn incurred a line loss of approximately 24 percent, which exceeds the allowable limit of 15 percent established by this Commission. In its last rate case proceeding,¹ Milburn's line loss was at issue and the Commission adjusted Milburn's purchased water expense to reflect the maximum water loss of 15 percent. Further, a review of Milburn's 3 previous annual reports reveals that historically, Milburn's line loss has exceeded the Commission's 15 percent allowable limit.

Milburn is aware of the Commission's concern regarding this issue and it has had ample opportunity to take the corrective action necessary to curb its line loss. Based on Milburn's test-period water sales of 7,463,835 gallons, adjusted to reflect the allowable 15 percent line loss, Staff has calculated a pro forma purchased water expense of \$8,781.² Accordingly, Milburn's purchased water expense has been decreased by an additional \$988, for a combined decrease to purchased water expense of \$1,961.

¹ Case No. 9300, Milburn Water District for an Adjustment of Rates Pursuant to the Alternative Procedure for Small Utilities, Order dated October 11, 1985.

² 7,463,835 Gallons + 85% = 8,780,982 Gallons.
 Water Rate - Per Gallon x \$ 0.001
 Purchased Water Expense \$ 8,781

Maintenance of Mains: Milburn reported test-period maintenance of mains expense of \$2,253. After reviewing Milburn's test-period invoices, Staff noted that the following expenditures are capital in nature:

Water Works; February 5, 1990	
Meters & Gaskets	\$424
D&N Construction; September 5, 1990	
3-Way Fire Hydrant	\$800

After consulting with the Commission's Engineering Division, it was determined that the meters and gaskets should be depreciated over 10 years and the 3-way hydrant should be depreciated over 40 years. Therefore, maintenance of mains expense has been decreased by \$1,224 and depreciation expense increased by \$62.³

Contractual Services: Milburn proposed a pro forma level of contractual services expense of \$1,790, an increase of \$412 above its test-period level of \$1,378. Milburn provided test-period invoices to support its proposed adjustment. Based on its review, Staff determined that the invoices Milburn provided were recorded in maintenance of mains expense and Milburn's proposed adjustment would result in a double recovery of these expenditures. Thus, Staff recommends that Milburn's adjustment be denied.

Included in Milburn's reported contractual services expense is \$303 in payments to McCoy and McCoy, Inc. ("McCoy") for testing performed in the test period. In 1991 McCoy increased its monthly

³ Meters and Gaskets	\$ 424 + 10 Years =	\$ 42
3-Way Hydrant	800 + 40 Years =	20
Adjustments	<u>\$1,224</u>	<u>\$ 62</u>

bacteriological analysis fee from \$13 to \$15. The annualization of this fee combined with the bacteriological checks performed in the test period results in an annual testing expense of \$240.⁴ Accordingly, contractual services expense has been decreased by \$63.

Insurance: Milburn proposed a pro forma level of insurance expense of \$1,869, a decrease of \$187 from its test period level of \$2,056. Milburn's adjustment is based on the insurance premiums it paid in 1991. To support its adjustment, Milburn attached a summary of its insurance coverages and premiums to its application.

Upon review of Milburn's insurance premium summary and available 1991 invoices, Staff is of the opinion that Milburn's adjustment meets the rate-making criteria of known and measurable and should be accepted. Accordingly, insurance expense has been decreased by \$187.

General Expense: Milburn reported test-period general expense of \$153, which includes \$54 of customer deposit refunds. Customer deposits are reported as a current liability on the utility's balance sheet. The refund of a customer deposit would be recorded as a reduction to cash and the liability account, and would not represent an expense to the utility.

⁴ \$15 Bacteriological Fee x 12-Months = \$ 180.
Bacteriological Checks + 60
Testing Expense 240

Milburn listed its refund of customer deposits as an expense in its general ledger. As with purchased water expense, Milburn's accountant failed to correct Milburn's error which resulted in an overstatement of the customer deposit account and test-period operating expenses. Therefore, Staff recommends that general expense be reduced by \$54.

Utility/School Tax: Milburn reported test-period utility/school tax expense of \$838. Milburn is acting as an agent of the taxing authorities to collect and remit utility/school tax. Accordingly, these monies should not be reported by Milburn as either an operating revenue or expense.

Milburn's normalized operating revenues do not reflect the collection of the utility/school tax and thus, Staff recommends that test-period operating expenses be reduced by \$838 to reflect the elimination of utility/school tax as an expense.

Operations Summary

Based on the recommendations of Staff contained in this report, Milburn's operating statement would appear as set forth in Appendix B to this report.

C. Revenue Requirements Determination

The approach frequently used by this Commission to determine revenue requirements for "non-profit" water utilities is debt service coverage ("DSC"). Staff recommends the use of this approach in determining Milburn's revenue requirement.

Staff has determined that Milburn's annual debt service is \$7,692.⁵ Milburn's adjusted operations reflect \$3,382⁶ in income available for debt service which results in a DSC of 0.44x.⁷ The increase in rates requested by Milburn would result in income available for debt service of \$13,779⁸ and a DSC of 1.79x.⁹

Milburn has requested a DSC of 1.2x, which Staff is of the opinion would allow Milburn sufficient revenues to cover its operating expenses, service its debt, and provide for reasonable equity growth. In this proceeding a DSC of 1.2x results in a revenue requirement of \$34,133.¹⁰ Thus, Staff recommends that

5	<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
	1992	\$ 4,000	\$ 3,188	\$ 7,188
	1993	5,000	3,038	8,038
	1994	5,000	2,850	7,850
		<u>\$ 14,000</u>	<u>\$ 9,076</u>	<u>\$ 23,076</u>
				+ 3 Years
				<u>\$ 7,692</u>
6	Adjusted Operating Income			\$ 2,845
	Interest Income			+ 537
	Income Available for Debt Service			<u>\$ 3,382</u>
7	\$3,382 + \$7,692 = 0.44x.			
8	Income Available for Debt Service			\$ 3,382
	Requested Increase			+ 10,397
				<u>\$ 13,779</u>
9	\$13,779 + \$7,692 = 1.79x.			
10	Debt Service			\$ 7,692
	DSC			x 1.2
	Subtotal			<u>\$ 9,230</u>
	Adjusted Operating Expenses			+ 24,903
	Revenue Requirement			<u>\$ 34,133</u>

Milburn be allowed to increase its annual operating revenue by \$5,848.¹¹

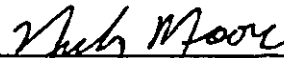
D. Rate Design

Milburn filed a schedule of its existing and proposed rates and did not propose any changes in the rate structure. The Staff agrees that the present rate structure should not be altered. Therefore, any increase granted in the case has been added to the existing rate structure. The Staff recommends that the rates in Appendix A, attached hereto and incorporated herein, be approved for services rendered.

E. Signatures



Prepared By: Mark C. Frost
Public Utility Financial
Analyst, Chief
Water and Sewer Revenue
Requirements Branch
Rates and Tariffs Division



Prepared By: Nicky Moore
Public Utility Rate Analyst
Communications, Water and
Sewer Rate Design Branch
Research Division

¹¹ Revenue Requirement
Less: Normalized Operating Revenue
Interest Income
Recommended Increase

\$ 34,133
27,748
- 537
\$ 5,848

APPENDIX A
TO STAFF REPORT CASE NO. 91-459

The Staff recommends the following rates be prescribed for customers of Milburn Water District.

<u>Customer Class</u>		<u>Rates</u>
First	2,000	\$9.25 per 1,000 gallons
Next	3,000	4.20 per 1,000 gallons
Next	5,000	3.35 per 1,000 gallons
Next	10,000	2.50 per 1,000 gallons
Over	10,000	2.00 per 1,000 gallons

APPENDIX B
TO STAFF REPORT CASE NO. 91-459

	<u>Actual Operation</u>	<u>Pro Forma Adjustments</u>	<u>Pro Forma Operations</u>
Operating Revenues:			
Unmetered Water Sales	<u>\$31,546</u>	<u>\$(3,798)</u>	<u>\$27,748</u>
Operating Expenses:			
Salaries & Wages	\$ 6,000	\$ 0	\$ 6,000
Purchased Water	10,742	(1,961)	8,781
Purchased Power	532	0	532
Postage	327	0	327
Office Supplies	50	0	50
Maintenance of Mains	2,253	(1,224)	1,029
Contractual Services	1,378	(63)	1,315
Insurance	2,056	(187)	1,869
Regulatory Commission Expense	50	0	50
Miscellaneous Expense	89	0	89
General Expense	<u>153</u>	<u>(54)</u>	<u>99</u>
Total Operating Expense	\$23,630	\$(3,489)	\$20,141
Depreciation Expense	4,200	62	4,262
Tax Other than Income Tax:			
Payroll Tax Expense	500	0	500
Utility/School Tax Expense	<u>838</u>	<u>(838)</u>	<u>0</u>
Utility Operating Expense	<u>\$29,168</u>	<u>\$(4,265)</u>	<u>\$24,903</u>
Net Operating Income	\$ 2,378	\$ 467	\$ 2,845
Non-Operating Income:			
Interest Income	537	0	537
Other Deductions:			
Interest Expense	<u>3,490</u>	<u>0</u>	<u>3,490</u>
Net Income/(Loss)	<u>\$ (575)</u>	<u>\$ 467</u>	<u>\$ (108)</u>